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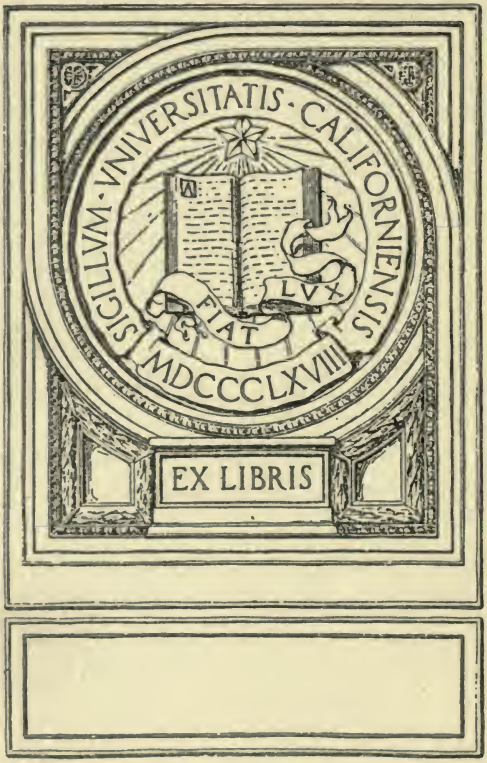
THE MODERN CREDIT COMPANY

ITS PLACE IN BUSINESS FINANCING.

ROBERT G. MERRICK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THE
MODERN CREDIT COMPANY
ITS PLACE IN BUSINESS FINANCING

UNIV. OF
CALIFORNIA

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ITS PLACE IN BUSINESS FINANCING.

BY
ROBERT G. MERRICK, Ph. D., Econ.

BALTIMORE
THE NORMAN, REMINGTON CO.
1922

UNIV. OF CALIFORNIA

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TO MY FELLOW COMRADES OF THE TENTH FIELD ARTILLERY, UNITED STATES ARMY, WHO MADE THE SUPREME SACRIFICE DURING THE WORLD WAR.

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INTRODUCTION

By Prof. Jacob H. Hollander, Ph.D.
Professor of Political Economy,
The Johns Hopkins University.

In economic affairs as in organic life there is certain to be structural adaptation to environmental change. That necessity which is the mother of invention finds here its best exemplification. Let the business world develop by growth or change a need for some new facility, and sooner or later the exchange mechanism will reshape itself by addition or amendment to satisfy this requirement.

The group of financial institutions whose gradual rise and rapid growth Mr. Merrick has described in the following pages represent an experience of this kind. Come into existence to meet a specific or a local need, their spread and increase reflect both the larger occasion for such facilities and the competent manner in which the new institutions have met the want.

It is desirable that the story should be told in a way that will satisfy both the practical need of business men and the scientific interest of economic inquirers. Mr. Merrick's chapters, reflecting his own dual equipment as student and as participant in affairs, serve this joint purpose. His investigation is pioneer, and I hope very much that, not content with blazing a serviceable trail, he will occupy definitely the field of which he here makes himself a productive student.

The Johns Hopkins University
March 7, 1922.

PREFACE

Baltimore is popularly known as the home of the credit companies. Their activities are more or less familiar to the average business man of that city. Being a resident of Baltimore this subject has repeatedly come to my attention. Among certain banking and credit circles it has been a much mooted question as to just what service the credit companies perform. What are the functions of the credit companies? Can their activities be justified? Do they foster overtrading? Are their rates ruinous? These and dozens of other questions have been spiritedly asked and just as spiritedly answered. There have been many heated arguments pro and con.

I felt that the truth could be arrived at only by a scientific and cold-blooded analysis of the problem. This I have endeavored to accomplish. Every effort was made to obtain the opinions both of those in favor of and those opposed to the credit companies; to eliminate as far as possible the personal equation; to investigate both sides of the question in a ruthless and unprejudiced manner, and to set forth the results obtained.

Most of the material was obtained by means of questionnaires, personal interviews, and correspondence with prominent bankers and credit company officials. I wish to express to these individuals my utmost appreciation for

their generous co-operation and assistance. The busiest executives gave me unsparingly and unselfishly of their time, and aided me with all the resources at their command.

I wish to express particular thanks to Mr. A. E. Duncan, Chairman of the Boards of Directors of the Commercial Credit Company of Baltimore, the Commercial Acceptance Trust of Chicago, and the Commercial Credit Company, Inc., of New Orleans; Mr. Arthur R. Jones, Managing Partner of the Continental Credit Trust of Chicago; Mr. John L. Swope, Vice-President of the Western National Bank of Baltimore; Mr. Albert D. Graham, President of the Citizens National Bank of Baltimore; all of whom have read part or whole of my work and aided me by many helpful suggestions and criticisms.

Mr. John L. Little, Secretary of the National Bond and Investment Company of Chicago; Mr. W. H. Crane, President of the Finance Service Company of Baltimore; and Mr. M. M. Prentis, former Manager of the Federal Reserve Branch Bank at Baltimore have all supplied me with valuable material and aided in other ways. Mr. William J. Flagg, of Baltimore, has helpfully criticized the composition of the manuscript.

To the members of the Political Economy Seminary of The Johns Hopkins University, and especially to Dr. Jacob H. Hollander, Professor of Political Economy, and Dr. George E. Barnett, Professor of Statistics, do I wish to extend my deepest appreciation for their kindly advice and assistance.

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THE MODERN CREDIT COMPANY

ITS PLACE IN BUSINESS FINANCING.

CHAPTER I

THE HISTORY OF THE CREDIT COMPANY IN THE UNITED STATES

The custom of borrowing money on transactions already entered upon, but not yet consummated, has been of long practice. For centuries cargoes of tea, coffee and spices shipped from the Dutch East Indies, that took several months to come around the Cape of Good Hope, prior to the building of the Suez Canal, were financed in Amsterdam on the arrival of the documents which came overland from India by the Caravan Route and were received some months in advance of the cargoes themselves.

It is a well known fact that John Jacob Astor borrowed money in New York on documents representing shipments

made by his clipper vessels from China. The documents came to Astoria, Oregon, and were forwarded overland, arriving in New York several months ahead of the goods. In the United States it has been customary for banks to advance money to exporters on documentary bills of exchange (i. e. drafts accompanied by bills of lading or other documents drawn on some banking concern abroad with which the consignee has arranged beforehand to honor).[1] It might be said that such loans were the forerunners of the type of financing practiced by THE MODERN CREDIT COMPANY.

By the term 'credit company' is meant that type of corporation which loans money on Receivables, and finances the sale of articles sold on the installment plan. The terms 'finance company' or 'discount house' [2] are often used synonymously for the term 'credit company'. These names should, however, be employed for other types of corporations. For purposes of convenience, and following logically from the names themselves, the author employs the above three terms as follows: (1) Finance companies, as designating corporations that deal in real estate mortgages, and perform a general and miscellaneous financing of business enterprises of all descriptions. (2) Credit Companies, which deal in (a) Receivables, that is, the accounts receivable of business firms, and (b) the financing of ar-

1 See "The Development of Mercantile Instruments of Credit in the United States," by Joseph J. Klein, Journal of Accountancy, Volume 13, 1912.

2 The terms Commercial Banking Company and Commerical Acceptance Company are also employed, and in the author's opinion these two are proper terms.

ticles sold on the installment plan, such as automobiles, furniture, musical instruments, etc. (3) Discount Companies which discount Bankers' and Trade Acceptances.

Neither finance nor discount companies are treated of in this paper. It is true that certain credit companies do perform types of general financing, as certain finance companies likewise purchase accounts receivable, and finance articles sold on the installment plan. However, the bulk of the financing done by the two is essentially different, so it is believed best to keep them separate.

The credit company is a financial institution which makes it possible for certain classes of business men, who have extended credit to their customers, to convert this credit into cash to be used in the further conduct of their business.

Unlike the practices of many European countries the merchant in the United States extends credit to his customers for from 30 to 90 days, usually allowing a small discount for cash payment. During this period of accommodation billions of dollars are thus tied up in what are familiarly known as 'frozen credits'. Nearly every merchant in the country, except those who do only a strictly cash business, has money owed him for merchandise and goods delivered to his customers. These bills receivable are popularly spoken of as 'open accounts'. It is only within the last two decades that banking corporations have been formed to loan money on these non-liquid assets. In a

country the size of the United States it is difficult to say exactly when the credit company first came into existence. It is, however, possible to state when the idea began to assume importance. It is known that the loaning of money on open book accounts antedates the formation of the credit company. Prendergast in his book, "Credit and Its Uses," published in 1906, says "It is probable that this method found its inception in a practice introduced some years ago, whereby a house, having no other form of collateral to offer its bank and being much in need of money, induced its bank to accept an assignment of certain accounts. Advances were made by the bank to an agreed percentage of the gross amount of the accounts assigned. This was an entirely private arrangement between the bank and its customers. When the bank had confidence in the integrity of the assignor and in the prospects of the business, it would permit the assignor to use the funds collected from the accounts assigned and in place of these collected accounts, other and supposedly desirable accounts were assigned to the bank, thus preserving the required ratio of margin. It will be evident that a bank lending under such conditions must have a good deal of confidence in the character and good intentions of the borrower for an unscrupulous person could deceive and defraud his banker. In the event of the failure of the borrower, or of any suspense in the relations between the bank and him, the bank would naturally enter upon the exercise

of its rights under the assignment, and the persons owing the accounts which had been assigned would be notified to make payment to the bank. In some instances, the notice of the assignment would be sent at the time of its execution, and the debtors called upon to make payment to the bank."

This latter method has been resorted to in the textile trade for the last fifty years or more by private bankers, factors and commission houses in New York City.[1] These firms filled the orders of salesmen by buying raw material, working it up into the finished product, shipping and billing it in their name for the account of clients. The salesmen then assigned the accounts over to the banker or factor, who, for his own protection, when the original invoices were sent to the debtors, thereupon notified the debtors of the assignment, and that payment must be made direct to him (the factor.)

The services of "The Bradstreet Company," one of the two national credit agencies, were employed by the author to discover certain statistical facts about credit companies. The dates of incorporation of all the credit companies in the United States were among some of the data obtained. As far as could be ascertained the first company formed solely to purchase open book accounts was the Mercantile Credit Company of Chicago. This concern was organized

1 See "The Sale of Open Accounts Receivable," by A. E. Duncan, published in "The Bankers Magazine," Volume C1, November, 1920.

in 1905 by Messrs. John L. Little and Arthur R. Jones. The former when questioned upon the formation of his company furnished the following information:

In the summer of 1904 he was engaged in the sale of the Encyclopedia Americana. As this work was sold on the monthly payment plan, it did not take him long to exhaust his working capital. At that juncture he happened to meet Mr. Arthur R. Jones, who financed him on his installment contracts. Their relations resulted in the formation of a partnership, the object of which was to form a corporation devoted solely to the purchase of open book accounts. Mr. Jones states that their principal thought was to standardize, elevate, and give respectability to this type of commercial banking, three features that were lacking particularly in his community. Before the Mercantile Credit Company was formed, Mr. Little, at Mr. Jones' suggestion, spent several weeks in New York City, investigating the various financial concerns operating there. He found many large corporations and financial concerns of the factor and commission house type, but nothing that would help him materially in his new project.

Mr. Little relates his initial problems as follows: "The first six months were devoted largely to laboratory experiments. The schedule or bill of sale had to be worked out. This was a legal proposition of no mean proportions. We proceeded on the theory that an assigned account would have to be collected by the assignee, but in actual experi-

ence we found that manufacturers, jobbers and wholesale dealers in good standing were unwilling to make an open assignment of their accounts. They thought to do so was an acknowledgment of financial weakness, and might reflect discredit upon the people to whom they sold. It was obviously necessary to overcome this obstacle." About that time the Supreme Court of Illinois handed down a decision to the effect that a man could assign his wages and appoint himself as agent with irrevocable powers to collect the same for the benefit of the lender. This furnished Mr. Jones and Mr. Little a clue to the solution of their difficulties, and in time resulted in the drawing of an Agency Contract, providing for the collection of an account by the assignor as the Agent of the assignee; in other words what is known as the Non-Notification Plan, which will later be described in more detail. The Agency Contract has been changed from time to time to meet changing conditions, but the basic idea has remained unaltered.[1]

In addition to the assigned account business some of the credit companies finance different concerns which sell articles on the installment plan; such as automobiles, furniture, farming implements, musical instruments, electrical appliances, gas heaters, and many other commodities. In some cases the credit company does not handle accounts receivable, but only the financing of the sale of a particular article or articles.

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1 See Appendix for reprint of a type of Agency Contract now in general use.

The credit company movement spread from Chicago to Baltimore and New York; and thence over the entire country. Today there are over one hundred and twenty-five[1] of these concerns, in nearly all of the industrial states of the Union. This rapid growth, however, has not been without its attendant obstacles and difficulties. The notification bankers have instituted legislation in different states to force the non-notification banker out of existence.[2] Receivers were loath to acknowledge the priority of assignments. The commercial bankers objected on different grounds. These objections are treated of at greater length in Chapter V. Suffice it to say that the credit companies are emerging triumphant from the struggle with their competitors, although the contest, in some states, is by no means over as yet.

In the following two chapters a description of the formation and functioning of the credit company and the types of financing it performs is presented in detail.

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1 That is, companies which purchase open book accounts, and finance individuals or firms which sell articles on the installment plan.

2 See "The Sale of Open Accounts Receivable," by A. E. Duncan, published in "The Bankers Magazine," Volume C1 November, 1920.

CHAPTER II

DESCRIPTION OF THE FORMATION AND FUNCTIONING OF CREDIT COMPANIES.

Credit companies are formed by an individual or group of individuals obtaining a charter from one of the States of the Union; usually from one where the State laws are favorable to such companies,[1] and where the taxes are not exorbitant. The authorized capitalization is almost invariably composed of a certain amount of preferred and common stock. The preferred stock is very similar to the preferred stocks of modern industrial corporations, with many of their preferences and limitations. The par value of the respective stocks is made to serve best the needs of the organizers. The general practice is to employ one of the following forms of capitalization: (1) to make both types of stock of equal par value; (2) the preferred from

1 It is interesting to note that of one hundred and twenty of these companies, of which information was obtained, forty-five are incorporated under the laws of Delaware.

ten to one hundred dollars par value, and the common of no par value, or of any convenient par value; (3) the preferred from ten to one hundred dollars par value and the common of one dollar par value. In certain states a large saving in taxes can be effected by this last method.[1] For the stock of no par value is often taxed on the basis of one hundred dollars par value, while that of one dollar par value is taxed only on that amount.

The stock is usually underwritten by some banking firm[2] which sells it to the public. As in most new flotations the organizers purchase for themselves a large block of the common stock,[3] and sell the preferred to the public with a small portion of the common. With every one hundred dollars worth of preferred stock purchased the investor may be given or sold from one-tenth to two whole shares of common, depending on the ratio between the amount of preferred and common stock authorized. In order to show the great variety and different modes of business in which the typical credit corporation is allowed to engage there follows a brief excerpt from the certificate of incorporation of one of the larger companies in the East. Many other companies have copied this wording almost verbatim.[4]

"The objects and purposes for which and for any of which this corporation is formed are.....

1 See Maryland Code of General Laws, and Delaware Code of General Laws.
2 Sometimes a group of individuals will underwrite the stock themselves and dispense with the services of a banking firm.
3 Not always the case.
4 From articles of incorporation of "The Commercial Credit Company of Baltimore, Maryland."

To buy, sell, pledge, exchange, dispose of, hold and own open accounts, commercial paper, bills of lading, warehouse receipts, bonds and securities, contracts, including personal property, leases and choses in action of any and every kind, nature and description.

To enter into, make, perform and carry out contracts of every kind, for any lawful purpose, without limit as to amount, with any person, firm, association or corporation.

To issue bonds, debentures or obligations of the corporation from time to time, for any of the objects or purposes of the corporation, and to secure the same by mortgage, pledge, deed of trust or otherwise . . . To purchase or acquire to hold, own, to mortgage, sell, convey or dispose of real and personal property of every class and description in any of the States, Districts, Territories or Colonies of the United States, and in any or all foreign territories, subject to the law of such State, District, Territory, Colony or Country."

After directors and officers have been elected, and the money received from the sale of its securities, the credit company is prepared to commence business. It usually employs one or more solicitors who endeavor to obtain as customers well rated manufacturers, jobbers and merchants. The solicitors' efforts are generally supplemented by advertising, circular letters, etc. Loans are now made, the credit corporation receiving as security such collateral as notes, assigned accounts, warehouse receipts, accept-

ances, bills of lading, liens of various descriptions, etc.

The credit company makes use of this collateral in a manner very similar to that which is employed by the member banks of the Federal Reserve Banking System in increasing their working capital. A great amount of the commercial paper which these banks hold in their portfolios is eligible for rediscount with the central Federal Reserve Banks of their respective districts. The Central Bank gives the member banks credit in return for the rediscounted commercial paper. Although the credit company is not allowed by law to rediscount its paper with the Federal Reserve Bank, it employs the next best procedure. It has already ratified a collateral trust agreement, by consent of its stockholders, with a trustee, with whom it deposits the collateral which has been received as security for its loans. This collateral is properly assigned and transferred to the trustee with the full right and power to exercise all the rights and privileges conferred on the credit company by the original holder. Against it are issued the credit company's own notes to the extent of about seventy-five to eighty per cent[1] of the collateral. The credit corporation has the right to increase the issue of its notes up to the figure provided for in the Collateral Trust agreement, but they are never to exceed seventy-five or eighty per cent[1] of the face value of the collateral assigned

1 These figures may vary from about seventy-five to eighty-five per cent with the different companies. On some types of high-grade collateral, notes are issued to the extent of eighty-five per cent of the collateral.

to the trustee. The credit company also has power to decrease the amount of notes outstanding, and to substitute other collateral or cash for that previously assigned; the notes, however, in no event are ever to exceed seventy-five[1] per cent of the face value of the collateral or cash actually assigned and held by the Trustee.

The credit corporation further guarantees its title to all collateral assigned to the Trustee. The Trustee in turn is not responsible or liable for the genuineness, validity or collectibility of the collateral, nor for fraud on the part of the credit company. He merely sees that the amount of collateral is sufficient to cover the issue of notes in accordance with the terms of the agreement. He is also empowered to act for the noteholders in case of default of interest or principal on the notes.[2]

These notes are placed with different banks and individuals. They consist of short term paper running from one to twelve months, and bearing, usually, from six to eight and one-half per cent interest per annum, depending upon the credit of the company; the laws of the different states; the type of bank taking the notes, whether a state or a national bank; and the market rate of interest at that time.

The custom of many of the credit companies is to borrow principally from their depository banks, keeping a

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1 See footnote on page 14.
2 Taken from an examination of several collateral trust agreements entered into by different companies with their respective trustees.

twenty per cent balance of their credit line on deposit and in addition paying the usual over-the-counter rate for loans, and liquidating once a year for a period of from one to three months. During the recent times of tight money bankers have, in some instances, required the credit companies, in the placing of their notes to leave a very large balance on deposit, thus making the rate paid by the credit corporation as high as ten or eleven per cent.[1]

The notes of well established credit companies are regarded by most bankers as a prime investment. In fact, the writer has made many inquiries but has been unable to learn of any case of a credit company defaulting on its collateral trust notes. This is not surprising, as they are a direct first lien obligation of the credit company, and are secured by (1) the obligation of the original "Payee" of each account (there may be as many as several thousand of these responsible debtors); (2) the guarantee of the "Seller;" (3) the minimum margin of twenty to forty per cent, the exact figures depending on the particular company; and (4) the assets of the credit company.

Besides placing these notes with their depository banks the credit corporations sell them through a brokerage house to banks and individual investors. The brokerage house agrees, as a rule, to keep a certain amount outstanding at all times. It is usually paid anywhere from one-half to one and one-half per cent per annum on the amount

1 The author knows of many such cases.

outstanding. Or the credit company may market its own notes direct to the banks and the individual investor. Or it may be that one or two banks or trust companies are fostering the credit company. The bank's officers may be directors in the credit corporation. The bank or trust company may accommodate the credit company by handling all of its collateral trust notes itself until the latter gets thoroughly on its feet. In other words the bank or trust company is foster parent to the credit company.[1] In some cases the credit company may be backed by several banks. Certain of the officers of these banks may have been the organizers of the credit corporation. In that case the latter finds it very easy to keep its collateral trust notes outstanding, and usually without being forced to pay a broker to place them.[2]

With the money that the credit company obtains from these notes it can make further loans, and the collateral which it obtains from these loans can in turn be deposited with the trustee and more collateral notes issued against them. This collateral consists of drafts, acceptances, bills of exchange, motor lien retail time sales and storage notes, warehouse receipts, and other liens. The credit companies[3] that perform general financing, in conjunction with their assigned account and installment financing business, have

1 City banks often "farm" these notes out to county banks at one-half of one per cent less than it paid for them.

2 The author knows of one such company where, out of twenty organizers, fifteen are bank officials. This, however, is very unusual.

3 The term FINANCE COMPANIES would be more appropriate for this type of concern.

many other types of collateral such as mortgages, stocks, bonds, etc. It is possible that eventually collateral trust notes of this type of company will be secured by different kinds of collateral—graded, guaranteed and selected to meet the investors' requirements. At the present time very few of the credit companies classify the collateral which is security for their notes.

The officers of a well managed credit company will see to it that its collateral trust notes mature evenly throughout the year; or if it is a specialized credit company, the notes will run to meet the requirements of the trade which the company is financing.

A later stage in the development of the credit corporation is the issuance of a second preferred stock which is junior to the collateral trust notes and the first preferred. This usually bears a higher rate of interest than the first preferred, and amounts to renting the money from the purchasers of the stock at a permanently high rate. It is similar to the type of second preferred stock issued by large industrial corporations and railroads. The credit company is not in a position to have this second preferred stock absorbed by the public, unless it has had a very good record and the second preferred is protected by a substantial surplus and a very valuable common stock. In fact, this issue of stock is very often much safer than the first preferred was when it was issued. Occasionally a small

amount of the common stock is allowed to be purchased along with the second preferred.

What may perhaps become a noticeable feature of many of the credit companies is the formation of a *trust* company. This is comparatively easy to form, as stock can be sold to the credit company's own satisfied stockholders. The credit corporation's customers also need little urging to carry their accounts with the new trust company[1]. In addition the credit company has its own account which it can carry there, and it is in a position to turn over to the trust company a good deal of business suited primarily to banks[2].

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1 The trust company proves of great convenience in handling the credit corporation's out-of-town business.

2 A credit corporation executive recently made the following statement to the author: "We hope soon to form a trust company; and when this gets thoroughly on its feet, our idea is to have a bond department, a real estate mortgage department, and a stock-selling department, selling stock in enterprises we finance, backed up by our guarantee. In other words we want a financial "wheel," and when any proposition is presented to us it will then only be a question as to which spoke of the wheel it belongs to."

CHAPTER III

TYPES OF FINANCING PERFORMED BY THE CREDIT COMPANY.

There are two main types of financing which the credit companies perform: (1) The purchasing of open book accounts. (2) The financing of a particular trade or trades. It is the practice of some of the credit companies to handle only the former, of others only the latter, while still others engage in a combination of the two types. It has already been explained how there flourished in certain trades a type of factors or bankers who loaned money on open book accounts. These accounts were assigned over to the factor or banker and notice of the assignment was given on the original invoice sent to the debtor (the one who owed the firm assigning the account) that payment must be made direct to the factor or banker.

The method used by most of the credit companies differs

from the above in that the debtor is not notified on the original invoice of the assignment, or at all, for that matter; and that the credit corporation trusts in the honesty of the assignor to collect the account and forward it to the credit company. The assignor also guarantees the payment of the account, both corporately and individually. It can clearly be seen that under the Non-Notification Plan (where the debtor is not notified of the assignment) the credit company must be very careful as to the moral and financial responsibility of the assignor. Frequently the credit corporation will refuse to buy an account under the Non-Notification Plan, but will handle the same account under the Notification Plan. This is done when the banker is unwilling to trust to the integrity of the seller of the account. Under the Non-Notification Plan the credit company has two parties to which it has recourse in case of non-payment and either of which can then be sued. However, the terms of the assignment may also be such under the Notification Plan that the assignor guarantees the account.

By many the Non-Notification Plan has been called secret. It is only more secret than the Notification Plan to the extent that the firm's customer is not aware of the assignment. Creditors have no way of finding out whether a firm sells its accounts or not, unless the question is directly asked. So any criticism of the Non-Notification Plan on the ground that it is secret can be held applicable only to the debtor. And what advantage can it be to him

to know that his creditor is or is not assigning his book account? He might, perhaps, regard it as a sign of financial weakness, and, of course, the same criticism, even if valid, would apply to the Notification Plan!

Below is the reasoning of Mr. A. E. Duncan, Chairman of the Boards of Directors of the Commercial Credit Company of Baltimore, the Commercial Credit Company, Incorporated, New Orleans, and the Commercial Acceptance Trust, Chicago, on this matter, and it seems to be well founded[1]:

"A few years ago, when the Non-Notification business was being developed and the total volume rather small, a misguided effort was made in certain credit circles to pass laws which, if enacted, would clearly have been class legislation, the expressed purpose being to prevent fraud through the 'secret' assignment of accounts and to enable creditors of a firm which was assigning its accounts to be informed thereof. The bills, in fact, prohibited the assignment of accounts unless the banker gave notice thereof on invoices sent the debtors (Notification Plan), but made no effort at all to restrict or make public the assignment of accounts if such notice were given, it being contended that if such notice were given, the news would 'leak out' and finally reach creditors.

"It has never been made quite plain just how Boston creditors of a Philadelphia manufacturer were expected

1 See "The Sale of Open Accounts Receivable," by A. E. Duncan, published in "The Bankers Magazine," Volume CI, November, 1920.

to find out that the Philadelphia firm was assigning its accounts to a New York Notification banker, simply because such banker, to protect his own interest, gave notice of the assignment on the original invoices sent to customers in Chicago, St. Louis, etc.

"The same interests which introduced and advocated such legislation supposed to protect creditors were, for some reason, much opposed to legislation introduced by the Non-Notification Bankers, which provided that every contract (or notice thereof) under which open accounts were assigned, whether upon the Notification or Non-Notification Plan, must be placed on record the same as a chattel mortgage, thereby making it easy for creditors to find out when any firm was assigning its accounts under any plan. There is no more reason or need for legislation to regulate the assignment of open accounts under any plan than of notes, drafts, acceptances, warehouse receipts, merchandise or other personal property. A firm can buy any amount of goods on open credit, place same in a public warehouse and borrow money on the warehouse receipt, leaving other creditors unsecured; can close open accounts into notes and is urged to close them into acceptances, which can be sold, discounted or assigned anywhere; can offer excessive discounts to its customers for cash; and can sell its merchandise, bought on open credit, to anybody and at any price.

"Why should such firms not also be at liberty to sell, discount or assign its open accounts? If one operation should

be restricted by legislation, why not all, as each offers opportunities for frauds upon creditors?"

In assigning accounts the credit company usually advances about eighty per cent of the face value thereof and holds twenty per cent reserve against each account, which is refunded the assignor when the account is paid in full by the customer. Mr. Arthur R. Jones, one of the pioneers of the Non-Notification Plan, states that his reason for instituting this practice in his company was as follows: "Early in the history of our business experience we concluded that it would not be safe to advance the *full face* of an invoice, because of the infirmities attached to an open account. At that time manufacturers and wholesale dealers were making approximately twenty per cent on their turn over. As a matter of business we felt that we could not afford to put more money into an account than our clients had invested. Hence an eighty per cent first payment, and the balance, less discount and deductions taken by the customer, became the fixed standard."

When a firm enters into an agreement to sell its accounts it signs a very rigid contract which grants broad powers to the credit company. Some of the principal terms of the agreement are: (1) that the assignor permits the auditors of the credit corporation to call at their pleasure to inspect his books and records; (2) pays their salaries and expenses of travel; (3) sends on the day of receipt thereof all original checks, drafts, notes, etc., received in payment or on account of any accounts sold to the credit company,

(4) gives the latter the power of attorney to transact any business relating to the assigned accounts—such as endorsing checks, drafts, notes, and other documents with the name of the assignor.[1] In addition to this contract the assignor signs the actual assignment of his title and interest in the different accounts. It is made out in triplicate, one copy going to the trustee, one to the credit company, and the third to the assignor.

Before a credit corporation will loan money to a concern on its assigned accounts it will carefully investigate its credit standing. This is done by several methods: (1) The mercantile credit agencies of "The Bradstreet Company" and "R. G. Dun and Company" are able to furnish very important facts as to the financial resources, the antecedents, the manner of meeting trade obligations, and the credit standing of practically any firm in the United States, and the more prominent ones in many other sections of the globe. The credit corporation is usually a subscriber to one or both of these agencies. (2) Each credit company possesses credit files of its own which it is building up and adding to all the time. (3) Its depository banks are able to furnish it with valuable information. They can write their correspondent banks in different localities for information desired about firms in the correspondents' immediate neighborhood. (4) The credit

1 This material was taken from the Agency Contracts of several credit companies. One is reproduced in full in the Appendix.

corporation often has its own representatives in the different sections of the country. They can investigate local concerns for the home office. (5) Attorneys-at-law act in a very valuable capacity in collecting credit information. (6) Access to the files of local credit associations, which serve as a clearing house for credit information, is often obtained by some individual associated with the credit company. (7) A questionnaire is employed[1] which includes a signed financial statement, checked up by one or more of the above methods. (8) The credit companies' solicitors obtain valuable credit information from other merchants and interviews with prospective customers. (9) The credit company often has its own credit men who are employed to keep it informed of the financial standing of its clients or prospective clients.

After a credit corporation has been doing business with a concern it exercises a very close supervision over it through the activities of its auditors. If the assignor of an account does not pay it when due, an explanation is asked for and the credit company's auditor examines the books of the assignor. If he finds that the assigned account has really been paid the assignor by the debtor he at once reports this fact to his company, which usually refuses to make further loans to the offending concern. There is thus a very strong incentive to live up to the original contract.

The question now naturally presents itself: For what reasons does a firm sell its accounts, and what class of

1 See appendix for reprint of this form.

firms is it that sell their accounts? The class of firms that usually sell open accounts are:[1]

"(1) Those who have a profitable business with an excess of energy, ability, and plant capacity over their invested capital, no matter how large they are. The extra profit on increased volume quickly covers the cost.

"(2) Those who have a profitable business and look upon a Credit Company, in a way, as a 'Silent Partner,' preferring to give a small portion of their profits to such company temporarily and continue to control their business, rather than give a large profit, extra salaries, etc., permanently to new partners or stockholders.

"(3) Those who have a large part of their invested capital tied up in real estate, plant, machinery or other fixed assets, as is the case especially with many manufacturers.

"(4) Those whose members are more experienced in the practical manufacturing and sales end of their business than they are in financing, and who dislike to borrow much money from banks and do not see the wisdom of carrying substantial cash balances.

"(5) Those who are located in towns with limited local banking facilities and who have not established banking connections in the larger cities.

"(6) Those who need 'extra' money temporarily for some special purpose, or to carry them over the 'peak' of their season.

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1 The Sale of 'Open Accounts Receivable,' by A. E. Duncan, published in "The Bankers Magazine," Volume C1, November, 1920.

"(7) Those who see the advantage of buying much cheaper for spot cash, or discounting, or paying their bills promptly at maturity, increasing their volume with but little increase of overhead, etc.; and can see where they can quickly offset the extra cost of the service."

In addition to the above classes of firms who derive benefit from the sale of their accounts, the author might mention:

(8) Those in a precarious condition, who face financial ruin unless they immediately obtain a certain amount of cash.

Evidence clearly points to the fact that as a business proposition it *pays* a certain class of firms to sell their accounts.

The credit company's charge is not excessive[1] in view of the fact that there is so much detail, investigation, and supervision connected with certain loans, and this necessitates a highly trained and expert staff. Its fees vary from one-twenty-fifth to one-thirtieth of one per cent per diem, plus a flat rate of about Five Dollars per One Thousand Dollars, until a volume of approximately One Hundred Thousand Dollars during twelve successive months is transacted with that firm. Then the flat rate is dropped. Some companies take their charge in the form of a discount. These charges are often supplemented by the fee charged for bonding.

1 Certain of the credit corporations or rather combination credit and finance companies have materially harmed the cause of the commercial banking companies by extorting enormous fees from customers urgently in need of funds.

Bonding[1]. When a firm assigns its accounts to a credit corporation, the latter assumes a threefold risk, namely (1) that invalid or fictitious accounts will be assigned; (2) that the assigned accounts will not be collected, and (3) that the proceeds, if collected, will not be turned over. The credit corporation protects itself to a limited extent by requiring the assignor to take out a fidelity bond with a surety bonding company, which, under certain conditions, guarantees that no *wholly fictitious* accounts will be *intentionally* assigned, and that the assignor will not misappropriate any money that may be actually collected.

This, of course, does not insure against number (2) occurring; as this would be credit insurance of the most advanced degree. It would be guaranteeing that an individual would pay his bills.

Instead of the above manner of insuring, many of the credit companies have their customers take out a type of fidelity bond which is known as a *moral effect* bond.[3]

The Installment Business. The role that the credit company[2] plays in the financing of the sale of goods on the installment plan must next be considered. It has already been mentioned earlier how there flourished in the larger

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1 See "The Principles of Surety Underwriting," by Luther E. Mackall.

2 This type of credit company is often called auto-finance company, automobile bank, or acceptance company, which last term is employed by the author synonymously with "credit corporation."

3 For further information concerning the "moral effect" bond address the author.

industrial cities a certain class of commission houses or factors which supplied the needs of those engaged in certain lines such as the textile, leather, and tobacco industries. Likewise credit companies have been formed to meet the needs of certain trades.

A brief survey of the financing of the distribution of automobiles and of the installment furniture business follows. The automobile trade is discussed because its financing plays a particularly large role in the activities of the credit companies; and the installment furniture business is treated of because it is more or less typical of the type of financing performed for various articles sold on the installment plan.[1]

The question that at once presents itself is: "How has the acceptance company come to play such an important part in the automobile business?" The reason for the development of the automobile-finance company can be directly traced to the distribution end of the business. "The automobile, despite the current assertions that it is a necessity, has always been looked upon by the commercial bankers as in a different class from staple products, as involving relatively large risks."[2] The dealers themselves usually have small resources for the volume of business they perform. They buy mostly on credit, and sell mostly

1 See article of H. G. Moulton on "Commercial Credit or Discount Companies, page 833, Journal of Political Economy, Volume 28, 1920. The author wishes to acknowledge the use of this material.

2 Ibid.

on credit. A great percentage of the automobiles sold are used for pleasure purposes. They are also subject to a rapid depreciation. In hard times it is very difficult to dispose of the second-hand car. In view of these circumstances the banks, in times of rapid expansion, have been very loath to extend credit to the automobile dealer for the distribution of his cars. It is this gap which the credit company fills. It makes loans to the dealer, for which it requires proper security. This security or collateral it hypothecates with a trustee, and against it issues its own secured debentures, which it sells to the banks. The banks then really extend an indirect credit to the automobile dealer, indorsed by the credit corporation.

Automobile financing divides itself into two types:

(1) Financing the dealer in his transactions with the manufacturer, known as the "Wholesale Plan."[1]

(2) Financing the dealer in his transactions with individuals, known as the "Retail Plan."

Under (1) advances are made up to about eighty-five per cent of the dealer's cost price of the machines, which are stored in warehouses or on the floor of the dealer's show rooms. A lien is retained on the cars, and in addition the dealer's promissory note is required. Often the manufacturer endorses the note or agrees to repurchase the cars. The machines are insured against fire, theft and conver-

1 Otherwise known as "The Floor Plan."

sion. The average length of these loans is from two to three months.[1]

Under (2) the finance company buys retail time sales lien notes, upon which the purchaser has paid one-fourth or more cash, the balance being due monthly, and pays therefor one hundred per cent of such notes, less its charges.[2] It requires the indorsement, guarantee, or promise of the dealer to repurchase the car. A lien is also retained on the cars, which are insured against fire, theft and conversion by the purchaser, and, in some cases, collision. The average length of these loans is from eight to twelve months.

The procedure described under (1) and (2) may vary slightly with different companies and in different states, but the underlying idea is approximately the same.[3] In some states chattel mortgages are taken on the cars; in others a conditional sale agreement or a lease with privi-

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1 See page 825, Journal of Political Economy, Volume 28, 1920.

2 When these notes are deposited with the trustee for the issuance of collateral trust notes against them, they are usually regarded as a better grade of collateral than assigned accounts, and collateral trust notes are issued against them to a greater ratio than against the assigned accounts.

3 It is interesting to note the existence of the Auto-Financing Credit Men's Association, Inc., with its main office in New York and branch offices in Pittsburgh, Chicago and Indianapolis, and a membership of forty-five automobile finance companies. The members of the Association file daily with the Clearance Bureau by card the makes and serial numbers of all cars financed both on the floor and retail plans. These cards are filed alphabetically according to makes, and serially according to numbers; and are then checked against cards previously filed for possible duplications, which when discovered are immediately reported to the member companies interested.

A system for the prevention of over-extension of credit to dealers has also been inaugurated, under which the members file with the Bureau the names and addresses of all active accounts. When two or more companies are found to be doing business with the same dealer they are notified. A further service is afforded to the members in the listing of dealers and purchasers, who from experience are known to be unsatisfactory credit risks. The Association also endeavors to foster and advocate legislation beneficial to the automobile industry.

lege to repurchase is used, while in others a trust receipt[1] is employed. The charges for the above operations are usually in the form of a gross service charge which amounts to about twelve to fifteen per cent per annum.[2] The insurance may be included in this or it may constitute an additional charge.

Insurance. The credit company usually protects itself, whenever possible, by different forms of insurance. When loans are made with personal property pledged as security, the acceptance corporation requires its customers to insure at least against fire and theft, and sometimes even further protects itself. In the case of automobiles, insurance is required against fire, theft, and sometimes against collision. The credit company requires its clients to place this insurance with whomever it designates. It usually makes a commission, itself, on the insurance, in one of several ways:

(1) It will agree with a certain insurance company or its agent to place with it all of its insurance during the year; and be allowed a commission or a reduced rate on this amount. The customer of the acceptance company pays the full rate.

(2) A credit corporation will often act as agent for an insurance company, thus receiving the agent's full commission.

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1 Under "Wholesale Plan."

2 That is, the gross charge amounts to that. It will be seen that the credit corporation receives interest for the total advance over the whole length of the loan. But as the notes are usually paid off monthly the credit corporation has the use of part of its money. This makes the charge much greater.

(3) The credit corporation will make arrangements with an insurance company or its agent to obtain a commission on all policies it is instrumental in having placed through it. This differs from (1) in that the credit company does not agree to place all of its insurance, and thus the commission is smaller.

We will now consider the activities of the credit companies in relation to the retail furniture business. In the United States there is at least one credit company devoted solely to the financing of the furniture installment business, and many others that engage in it to a limited extent. Approximately eighty-five per cent[1] of the furniture purchased by the public in this country is sold on time. The furniture dealer usually takes a chattel mortgage or conditional sale of contract on these goods.[2] He requires, in most instances, an initial payment with the promise to pay the remaining installments monthly over a six to twenty-four months period. These contracts of conditional sale are then assigned to the credit company, which usually advances from fifty to eighty per cent on their face value. The credit corporation requires the indorsement, guarantee or agreement of the dealer to repurchase the contracts. The margin of profit is rather large in the furniture installment business, so the dealer can easily afford

1 From statistics compiled by The Grand Rapids Furniture Record, Grand Rapids, Michigan.

2 Selling on Conditional Sale of Contracts has been so general that the Commissioners on Uniform State Laws have adopted a uniform act relating to Conditional Sales. This is being sponsored by members of the National Association of Credit Men. It has been adopted by at least seven states. For further information communicate with the Uniform Sales Service Company, 1133 Broadway, New York.

to pay the credit company's charge which is indeed small when compared with the retailer's profit.

The president of the credit company devoted solely to the financing of the retail furniture dealer told the author that he has found it unnecessary to demand that the furniture be insured, as the individual accounts are so small and the risks so diversified that the possibilities for losses are minimized, and it pays the furniture dealer to carry his own insurance. What has been said above about the financing of the installment furniture business applies with slight modification to the financing of numerous other articles, such as pianos,[1] pianolas, gas and electric appliances, etc. Other commodities, such as trucks and tractors, are financed in a manner somewhat similar to the automobile. Credit companies, also, often make loans ranging from forty to eighty per cent of the cost price on the warehouse receipts of any staple commodity.

During the recent fall in prices of nearly all articles, credit corporations have been forced to exercise great discretion in their loans. In certain lines of industry such as the fur, silk, woolen, cotton, shoe, shipbuilding, automobile and kindred trades there has been a tremendous number of failures. Credit companies and banks alike have had to cope with unusual maladjustments in trade and industry.

1 The terms of credit for pianos and pianolas, in some cases, are as long as five years.

CHAPTER IV

THE ASSIGNED ACCOUNT AND THE TRADE ACCEPTANCE

As the trade acceptance and the assignment of open book accounts are each employed to convert a non-liquid asset into cash, the author feels that in a work devoted to the treatment of the latter, the relative merits and demerits of the two should be discussed and analyzed. A short explanation of the trade acceptance is first given. Then an attempt is made to show the advantages and disadvantages of the two different methods.

The use of the trade acceptance, in the form of bills of exchange, for payment of goods is almost as old as commerce itself. It is even maintained by some writers that the latter were used by the Assyrians as early as the seventh century B. C.[1] Macleod ascribes their origin to the Ro-

1 See Nys, "Economic Researches." He quotes François Lenormant on the Assyrian inscriptions.

mans[1]; and Montesquieu speaks of their early use by the Jews.[2]

Prior to the Civil War the trade acceptance was employed in certain sections of our own country.[3] The usual term of credit on merchandise transactions, however, was about four months in the East and from six to eight months in the West, with the buyer giving his promissory note.[4] During the War and up to the crash of 1873 most transactions were for cash.[5] This was probably due to the instability of the times, the lack of confidence in the prevailing media of exchange and the great abundance of notes (greenbacks) in circulation.[6]

Since the crisis of 1873 there has developed the granting of credit on the open account. The great growth of banks and the increase of capital have undoubtedly helped this movement. Also each manufacturer and wholesaler vied with his competitors in extending easy terms to his customers.[7] Due to the risk and uncertainty attending long credits discounts for cash were offered in order to insure prompt payments; and gradually the open book account system was evolved.[8] On account of the great development and improvement in all forms of transportation and

1 See Macleod's "History of Banking."
2 See Montesquieu's "Esprit des Lois," Book XXI, Chapter XX, Vol. IV of Oeuvres Complètes. Edition Edouard Laboulaye, Paris, 1877.
3 Jos. J. Kelin's "Development of Mercantile Instruments of Credit," Journal of Accountancy, Vol. 12, p. 333.
4 Ibid, Vol. 13, p. 45.
5 Ibid, Vol. 12, p. 527-528.
6 American Acceptance Council Literature and Park Mathewson's "Acceptances, Trade and Bankers'".
7 See American Trade Acceptance Leaflet "Why Accept?"
8 "Trade Acceptances, What They Are and How They Are Used," by Robert H. Treman, formerly Deputy Governor, Federal Reserve Bank, N. Y.

communication the terms of credit have steadily tended to become shorter.[1] The prevailing custom has been to extend credit on open accounts with from 30 to 90 days in which to pay, and with a discount allowable for cash within from 10 to 30 days, the exact figures varying in different trades and with different merchants.

In order to release this money tied up in open book accounts and to promote a healthier credit condition the Federal Reserve Board has sought to reintroduce the "Trade Acceptance," widespread use of which was not possible under the old National Bank Act. One naturally asks what this resuscitated type of commercial paper is. "A trade acceptance is a draft drawn by the seller on the buyer, having a definite maturity, and payable in dollars in the United States without qualifications, and signed by the buyer across the face acknowledging a debt for value." This "double name" paper has been christened a "Trade Acceptance" by the Federal Reserve Board. It is employed only in business dealings that effect the sale and purchase of goods. In order to be eligible for rediscount by the Federal Reserve Banks it must arise out of a current merchandise transaction. It cannot be given for borrowed money or overdue accounts,[2] nor for commissions of any kind, sales of bonds or stocks, professional services,

1. See Prendergast, "Credit and Its Uses."
2. Bankers, however, cannot tell when an account is overdue, if an individual wishes to practice deception.

or any debts not incurred through the purchase of goods from the drawer.

The trade acceptance is employed to a great extent in Canada[1] and Europe. When a merchant ships commodities to a buyer he sends an invoice of goods with trade acceptance attached, drawing on the buyer for a definite sum, payable at a definite maturity. The buyer writes his name, the place where he wishes to make payment, and the word "Accepted" across the face of the draft and returns it to the seller. The latter can take this to his banker and have it discounted, and thus not have to wait for his money until the maturity of the acceptance.

In the United States the practice is to ship goods to a customer and quote him a discount for cash within so many days, and net thirty, sixty or ninety days. If payment is not made then the seller decides what action he wishes to take. He can extend more time or refuse to make further shipment of goods until his old accounts are paid. And during this period he is acting as banker for his customers. It was hoped that the Federal Reserve Act creating the favored "Trade Acceptance" would induce bankers and business men to take advantage of this means of payment and so release billions of dollars of "frozen credits," and allow a greater volume of business to be done on the same amount of invested capital.

1. See Park Mathewson's "Acceptances, Trade and Bankers'."

The *theory*[1] of the acceptance payment is that the member bank discounts the trade acceptance for the merchant, and obtains its money wherewith to do this by rediscounting it with the Central Federal Reserve Bank of its district.[2] When the acceptance is paid by the acceptor to the bank, it can employ this money[3] to pay back the Federal Reserve Bank the amount borrowed from it. Thus all credit transactions of this character, under normal conditions, would completely liquidate themselves. It must be understood that in actual practice the merchant often does not discount the acceptance, and when he does, the member bank in turn often does not rediscount it.

The Central Federal Reserve Banks in the past have given the member banks a preferential rate in rediscounting the trade acceptance, with the expectation that they would pass this on to their customers, thus serving as an incentive for them to adopt the "acceptance idea." Unfortunately the member banks have not always passed this preferential rate on to the business man.

The Assigned Account and the Trade Acceptance. What is the difference between selling an open account to a credit company and selling a trade acceptance to a bank?

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1. That is, the theory of the acceptance as regards discounting and rediscounting; as with other eligible paper.
2. Resorted to more in times of money stringency.
3. Actual currency rarely employed; performed by means of credit.

Discounting an acceptance is a much cheaper method than selling an account. The former can be done for about six per cent and the latter costs about eighteen per cent per annum. The banker might take this into consideration in his single-name line of credit, and curtail to a greater degree the loans of the firm which sells its accounts, as this is the more expensive and less desirable method.

Let us examine the effect of the two on the credit structure of the country. A., a merchant, has a customer, B. He obtains a trade acceptance for goods shipped to B. to the extent of, say $1,000.00. A. discounts the acceptance with his banker, who in turn can rediscount it with the Central Federal Reserve Bank of his district and receive credit to the extent of $1,000.00 less the discount rate, which may be anywhere from four per cent to seven per cent. The banker now can have this money ready to accommodate on some other loan. In other words the acceptance can create the currency which is needed to finance itself.

Let us see what would have happened if A. had sold his $1,000.00 account owed him by B. to a credit company. He would have obtained eighty per cent of the face value of the account, less the discount charged by the credit corporation, and had this money with which to do as he deemed for the best interests of his business. The difference so far in the two methods is, A. pays more under the latter method and receives much less cash. But let us

follow the matter further and see what is the result. The credit company takes this assigned account in conjunction with many others and deposits them with a trustee, and then issues its own trust notes with this collateral as security. These are sold to banks and individuals. With the money received from their sale it buys more accounts or makes more loans, and then issues more collateral trust notes against this additional collateral.

These notes, unlike the trade acceptance, are not eligible for rediscount with the Federal Reserve Bank. On each turn-over of invested capital they are scaled down twenty per cent, while the acceptance is rediscounted for one hundred per cent.[1] The acceptance also serves as a secondary reserve for the member banks when rediscounted with the Central Bank. It appears then that greater expansion is possible with the acceptance than with the assigned accounts. However, as all the former must pass through the hands of the banker it is possible for him to exercise a wise supervision on undue expansion.[2]

Summary. The trade acceptance is cheaper than the assigned account. It can be discounted for one hundred per cent instead of eighty per cent and thus supplies more money to the borrower. It is more attractive to the banker as it is eligible for rediscount, and counts as a secondary

1. Of course the acceptance may not be turned over more than once, or at all for that matter.

2. The banker claims that the credit companies are interested only in the safety of their loans and the resulting profits. This criticism is unfortunately only too true, in some cases. However, it would apply equally well to many banks.

reserve, and in addition allows him an oversight of the merchant's business. It looks as if the trade acceptance is a more ideal form of closing an open account than selling it to a credit corporation. Why has the acceptance then not come into general use?[1] There are several reasons:

1. The Trade Acceptance is a radical departure from the open book account system which has been in vogue for the last fifty years.
2. The buyer at the bottom of the pyramid does not give acceptances, and this is bound to react upon the different strata of the pyramid.
3. The acceptance does not satisfy the requirements of certain trades.
4. The vast size of our country presents a serious obstacle.
5. The United States Treasury Certificates of Indebtedness offered on the market have absorbed huge sums that would have been available for acceptances, and on account of this the acceptance movement has been somewhat retarded.[2]
6. The present Call Money System.[2]
7. The abuse of the acceptance by unscrupulous indi-

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1. Total volume of trade acceptances discounted for member banks, and bought in the open market by the twelve Federal Reserve Banks, taken from the seventh annual report of the Federal Reserve Board:

	1918	1919	1920
Discounted for member banks	187,373,000	138,420,000	192,157,000
Bought in the open market	61,036,000	36,558,000	74,622,000
Total	248,409,000	174,978,000	266,779,000

2. See "Problems and Progress with Dollar Acceptances" by Jerome Thralls, published by the American Acceptances Council.

dividuals has robbed certain bankers of their wholehearted support of the idea.[1]

Let us first consider (1).

(1) Since the Civil War business has been done on the open account plan in the United States. To introduce an entirely new system is an herculean task in itself. Immediately everyone has to be convinced that the new system is superior to the old. The selling of open accounts on the other hand does not require the merchant to spread propaganda. It is merely a private agreement between him and the credit company. In addition there are many other objections to the acceptance such as the following:

(a) A certain class is entirely satisfied with the present system.

(b) Bankers complain of increased paper work.

(c) Buyers that they do not benefit by it.

(d) That it ties them down to a definite day of payment.

(e) There are many other objections some of which do not rest upon a solid ground, but can only be overcome by an aggressive "missionary" campaign which the average business man and banker have shown themselves unwilling or unable to undertake. The former often says it is the banker's

1. See "Problems and Progress with Dollar Acceptances," by Jerome Thralls, published by the American Acceptance Council.

place to "push the idea"; the latter says it is the business man's.

(2) It is a mere platitude to state that the retailer is forced to give credit to the ultimate consumer. This being the case it is asking a good deal of the retailer to accept for the jobber or manufacturer. In France the retailer has been very successful in obtaining what practically amounts to an acceptance from his "charge account" customers.[1] When they make a purchase of goods and do not pay cash for them they are asked to sign a slip which, in reality, amounts to a trade acceptance. These slips can be borrowed upon at the bank[2].

Following is a quotation which shows the attitude taken by certain members at a recent semi-annual conference of a big retailers' association.

"On the conclusion of Mr. W's address, Mr. S. opposed the use of trade acceptances by manufacturers and wholesalers in their dealings with retailers. He emphasized the fact that an acceptance amounted to the same thing as a note, the retailer being bound thereto. The trade acceptance, Mr. S. said, was a fine thing for the banker and for the wholesaler, but he did not see how it could be made of any real advantage to the retailer.[3]"

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1. Of $3,000,000,000 worth of acceptances discounted in one year under pre-war conditions by the Bank of France, the average was only about $100 and some acceptances were as low as $1.00, there being more than $500,000,000 discounted in amounts less than $25.00. It is well to note, however, that many of these so-called acceptances are really drafts.

2. The ultimate consumer, however, does not expect to resell the goods he purchases, and in the United States we should not call a draft drawn by the retail dealer upon the ultimate consumer a true trade acceptance.

3. It is interesting to note in this respect that certain credit companies do not incline to purchasing the accounts of retailers, some even going so far as to refuse their accounts.

(3) The acceptance does not meet the requirements of certain trades. This can perhaps best be explained by the following resolution which received the unanimous indorsement of the executive committee of the National Grocers' Association at a meeting held in Washington, February, 1918:

"Whereas, We appreciate the advantages of the trade acceptance in certain lines of buiness and its general desirability from a banking standpoint; and

"Whereas, The wholesale grocery business has advanced to the point where it is conducted on a short term basis; and

"Whereas, The adoption of the trade acceptance in the grocery trade would have a tendency to lengthen terms and increase credit risks, therefore be it

"Resolved, By the Executive Committee of the National Wholesale Grocers' Association of the United States, that the general adoption of the trade acceptance in the grocery trade, under prevailing grocery-trade conditions, would really be a step backward."

(5), (6) and (7) As these last three reasons have no direct bearing upon the assigned account a discussion of them is deemed out of place.[1]

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1. For this see "Problems and Progress with Dollar Acceptances" by Jerome Thralls.

CHAPTER V

ANALYSIS OF THE PROBLEM

The types of financing performed by the credit company have already been explained at great length. It now remains to be considered whether its activities can be justified. That is, are sound business methods being fostered by the credit corporation; and just what effect do these types of financing exert upon the general credit structure? A discussion of these problems divides itself into two heads: (A) Is the selling of open book accounts a wise or unwise practice in its relation to the effect it exerts upon the credit system of the country? (B) Is the financing of the sale of articles on the installment plan a wise or unwise practice in relation to the effect *it* exerts upon the credit system of the country?

(A) There can be no doubt as to the general advisability of the selling of open book accounts in certain cases: (1) There are many firms which have a profitable business

with an excess of energy, ability and plant capacity over their invested capital. The banks will not fully accommodate them. The credit companies have served this type of firms to great advantage, and many small business enterprises have grown to large proportions through the employment of their services. It is difficult to see where a reasonable accommodation of this class of concerns can produce a strain on, or an unwise expansion of, our credit system.

(2) There are those firms which employ the commercial banking company as a "Silent Partner." A business concern often needs more capital temporarily, and is willing to share its profits for the use of it. The credit corporation furnishes money at very short notice at a fixed percentage and the borrower can expand and contract his "line" almost at will, a procedure which could not be easily effected if an individual were acting as a partner. With proper supervision there is very little danger of unwise business expansion.

(3) Many business concerns have a large percentage of their assets tied up in plant, equipment, machinery, etc. Bankers often advise them to place a mortgage on their plant and to employ the proceeds in the regular conduct of their business. For various reasons it may be impossible to effect this advantageously.

The usual practice with banks is to loan about 50 per cent on the accounts receivable, provided other items in the financial statement of the borrower are satisfactory. If a large percentage of a firm's capital is in fixed assets,

it might be considerably restricted in its activities by only being able to borrow this amount from its bank. Recourse is had to the credit company. It will loan eighty per cent on the face value of the borrower's book accounts. He will then have thirty per cent more working capital than if he had borrowed from the bank. If the increased profit from this additional capital more than offsets the difference between the bank's and the credit corporation's charges the borrower benefits more by utilizing the latter.

(4) There is that class of firms which have inadequate banking facilities in their own neighborhood.[1] Accommodating a concern in its legitimate financing merely because its local bank is too small to provide adequately for it, is certainly not putting an unnecessary strain upon the credit structure.

(5) There are those firms which seek accommodation from the credit company at the "peak" of their season. In this case there is danger of overextension unless a very wise supervision is maintained.

(6) There is that class of firms which by borrowing from a credit company can discount its bills and buy at a low rate for spot cash. The credit companies' charges are often less than the discounts offered. This promotes a healthy condition, as bills are met promptly, a quicker liquidation of accounts is secured, and the credit system thereby im-

1 A national bank can only loan 10% of its paid in capital and surplus to any one individual or firm. The individual State Laws governing state banks are modelled along the same lines.

proved. Millions of dollars worth of "frozen credits" are released yearly by this procedure. James Edward Hagerty, author of "Mercantile Credit," has compiled the following figures on the rate of discounts in different trades: "It varies from six per cent to seventy-two per cent a year, while the average annual rate is between twelve to eighteen per cent. In fixing discounts for cash, manufacturers and jobbers may wield a ready weapon to force cash payments. As a rule the longer the term of credit the higher is the rate of discount, because the more uncertain the payment of the obligation. Discounts on groceries average around twelve per cent a year;[1] on textiles about eighteen per cent; while on certain kinds of jewelry the rate is as high as seventy-two per cent a year." It can readily be seen that it would pay a concern to sell its accounts where the rate of discount it received for making cash purchases for its own needs is greater than the credit company's charge.

In all of the above cases the author has sought to show that under proper supervision firms which deal with the credit company not only profit thereby, but that such accommodation does not constitute a strain on, or unwise expansion of, our general credit structure. As to whether this last fact is true or not depends almost entirely upon the supervision of each individual credit company.

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1 It is interesting to note that if a concern's sales terms are 1% for 10 days, net 30, it would be offering 1% for only 20 days' time (from the 10 days' discount date to the 30 days' due date). Hence if Mr. Hagerty's figures are based on 1% for 10 days, net 30, his discounts on groceries would be more nearly around 18% a year.

(7) There is a class of firms that sells its accounts in order to avert financial ruin. One of two things eventually happens in this case; the firm fails, or is tided over its precarious condition. If it fails the general creditors suffer at the expense of the secured creditor—the commercial banking company. If it does not fail the credit company has often saved the concern in question from financial ruin.

(8) Certain firms are in the habit of borrowing their limit from the bank on their single name credit, and, unknown to the banker, hypothecate their accounts with a commercial banking company, borrowing additional money on these. For this reason many bankers object to the activities of the credit corporations. This is a well founded objection, unless the assignor of accounts furnishes a true statement of his assets and liabilities to the credit company; and it, in turn, keeps its loans down to a safe margin. Yet if an individual practiced deception on the bank, he would also be very likely to practice it, if to his advantage, on the credit company, so it in turn should greatly discourage such a procedure.

The signed financial statement that customers submit to their banks should always contain a question:[1] "Have you ever assigned any of your accounts?" If a borrower answers this honestly, a check can be exercised on his selling of his accounts. If he stoops to deception and answers untruth-

1. This is the practice with many banks.

fully, it is very likely that he would deceive the bank in other matters, even if no institution such as the credit company existed. It appears as if it is a question of dishonesty on the part of the customer, and the commercial banking company should be blamed only to the extent that it makes such dishonesty an easy practice.[1]

(B) *Financing the Sale of Goods on the Installment Plan.* It has previously been shown how the automobile dealer is financed in his transactions, both with the manufacturer and with his own customers. In the majority of instances the banks have been unwilling to finance the automobile merchant as his business was regarded as involving too much risk. The credit corporation acts as the intermediary between the two, borrowing from the banks on its own notes, secured by the chattel mortgages on the automobile dealer's cars. A very essential link in the credit chain is thus supplied.

Is there an unwise extension of credit in this procedure? As the credit corporation's rates are fairly high the dealer, unless forced to, does not take from the manufacturer more cars than he has reason to suppose he can sell. As many of these cars are sold on credit to individuals, the commercial banking company's rates and terms are such as to make him hesitate before buying on credit, unless he has good reason to think his payments can be met. The credit company thus has its wholesale and retail plans act

1 If cooperation between the bank and credit companies or some method of recording were possible it would tend to solve this problem; which by many bankers is considered the most serious drawback to the activities of the credit company.

as a check one upon the other, and a mild restraint is exercised upon undue credit expansion.

One indication that the credit companies do unwisely expand credit seems to be borne out by the fact that they frequently have "public auction sales" of automobiles, which have been seized, due to non-payment, under the chattel mortgage or conditional sale of contract agreement. The frequency of these sales[1] and the number of cars sold in that way determine whether the credit companies have extended credit to foster a wise purpose. Yet would there not exist to some extent this same state of affairs even if the acceptance corporation did not supply the needed credit?

It can be stated with confidence that the credit company fills a real gap in the credit system when it finances the automobile. Acting as intermediary between the bank and the dealer, it increases the possibility of its distribution. Nevertheless, the number of auction sales held at periodical intervals raises the question of the measure of responsibility attaching to them for the injudicious purchase of automobiles by many who could not afford them. The credit companies have to this degree extended an unwise credit. Yet these repossessed cars are sold under the hammer and ultimately find their way into the hands of the public, either direct or through the medium of a second hand dealer. They are eventually absorbed.

1 The author is compiling statistics on this point and hopes to have them ready for publication at a future date.

The following figures taken from the statements of three representative credit companies located in Baltimore, New Orleans and Chicago furnish a fair index, first, of the percentage of cars that are seized under the conditional sale of contract agreement and second, of the character of the assigned account business.[1] These figures were taken from their financial statements as of June 30th, 1921:[2]

Baltimore Company. Of $2,945,853.41 Motor Lien Retail Time Sales Notes, only $40,389.03, according to original terms of sale, were over 60 days past due.

Of $730,367.98 Motor Lien Storage Notes and Acceptances, which includes some renewals and extensions, $21,410.33 were over 60 days past due.

Of $7,025,543.54 Open Accounts, Notes and Acceptances, $181,435.73, including $102,265.87 against Railroads, Counties, Cities and Towns, were over 60 days past due.

Chicago Company. Of $1,667,106.91 Motor Lien Retail Time Sales Notes, $36,788.47, according to original terms of sale, were over 60 days past due.

Of $1,010,741.19 Motor Lien Storage Notes and Acceptances, which includes a few renewals, $19,249.61 were over 60 days past due.

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1 The author asked the Chairman of the Boards of these Companies if a particular effort had not been made, previous to the printing of these statements, to close out all bad accounts so that a favorable showing could be published. He replied that some slight effort had been made, but that the above figures were a pretty fair index of the character of the business performed by each company.

2 It is not maintained that these figures prove anything, but merely that they show what is possible of performance by well-regulated credit companies.

Of $1,617,905.14 Open Accounts, Notes and Acceptances, $43,138.22 were over 60 days past due.

New Orleans Company. Of $1,078,422.66 Motor Lien Retail Sales Notes, $91,451.50, according to original terms of sale, were over 60 days past due.

There are undoubtedly many cases where the credit companies perform financing which is not to the best interests of the business community. They often furnish money for enterprises which are unsound, but in which they are adequately protected. It is the borrower, forced to meet his charge of one and one-half per cent a month, who faces ultimate failure. Yet the fact remains that some of the older companies have on their books today customers who have been dealing with them for years, and each successive year shows increased profits for the borrower. The author has made an effort to obtain statistics on this point. But because of the fact that the number of credit companies, which have been in business a sufficient length of time to draw reliable conclusions, is so small, and because the change in the personnel of the customers is so great, the statistics have not been deemed of sufficient weight to publish.[1]

However, the following figures and statements, taken from a confidential report of one of the oldest and per-

1 It must be borne in mind that the customers of a credit company fall into three classes: (1) Those who have continuously employed the services of the credit company in the past, and will continue to in the future. (2) Those who employ the services of the credit company at regular or irregular intervals. (3) Those who use the credit company just temporarily, and never have recourse to it again. This includes that class which fails while yet customers of the credit corporation.

The difficulty of collecting reliable statistics on account of the change in personnel of the clients of the credit company can easily be perceived.

haps best nationally known credit corporations in this country give the reader a very clear insight into the business methods and policies of a representative credit company.

To the question "What is the usual size and credit rating of your customers"? the following answer was received:

"Exclusive of motor vehicle paper, for the ten months ended October 31, 1921, our gross purchases of accounts were $34,022,131.42, purchased from and guaranteed by 167 different manufacturers and jobbers rated in Dun or Bradstreet, September 1921 book as shown below, also our current accounts receivable, $8,386,848.38 outstanding October 31, 1921, were purchased from and are guaranteed by such concerns similarly rated, divided as shown below.

CUSTOMERS' RATING	PURCHASES 10 MONTHS OCTOBER 31, 1921			OUTSTANDINGS AS OF OCTOBER 31, 1921		
September, 1921 1st or 2d Credit	Amount	No. Customers	Per Cent	Amount	No. Customers	Per Cent
$1,999,000 or over....	$6,332,040.00	7	18.6	$2,215,259.85	6	26.8
500,000 or over....	8,787,778.02	9	25.8	2,922,002.58	7	34.8
300,000 or over....	12,395,239.90	15	36.4	3,724,654.14	14	44.4
125,000 or over....	18,121,971.06	33	53.3	4,803,288.02	24	57.3
75,000 or over....	21,278,457.09	38	62.7	5,779,506.54	32	68.9
20,000 or over....	26,299,433.56	78	77.5	7,014,946.89	65	83.6
All other ratings or no rating.....	7,665,241.22	89	22.5	1,371,901.49	53	16.4

"This shows that 77½ per cent of the above purchases were made from firms having a first or second credit rating in the September 1921 Agency Books, and 34.9 per cent of our customers have increased ratings in the September 1921 Agency Books over the rating such customers had when they began dealing with us.

To the question "Do you take only a certain class of receivables, e.g., (a) maker rated (b) of specific size, (c) any other limitation?" the following reply was given:

> "A fixed policy of our business is that what we purchase should be primarily good for amount of our advance, and the firm from whom same was purchased considered secondary. (a) We usually do not take over 20 per cent of the outstandings with a given firm which is not rated first or second credit. (b) We watch and limit the size of an individual account according to the primary credit of the purchaser, secondary credit of the seller, or the guarantors on the seller's contract, having in mind also the margin withheld. (c) Depending upon our experiences with the Receivables of a given concern as well as the firm itself.

Furniture Financing. The financing of the retail furniture dealer who sold on the installment plan was described in a previous chapter. Why is it that the banks do not handle this business? In the first place eighty-five per cent[1] of all furniture is sold on time. The reason for this is that it is the only quasi-necessity of life the cost of which amounts to several hundred dollars. The average purchaser cannot afford to pay out this amount except over a long period of time. The furniture dealer must extend him credit. This amounts in some cases to as much as two years. Banks have not made it the custom to extend credit for so long

1 Statistics furnished by "The Grand Rapids Furniture Record."

a period. They often ask for a four or six months note from the furniture dealer, who usually finds it very embarrassing to make payment when the note falls due. He is thus considerably hampered in his business activities. The credit company performs a very much needed service. It will supply a much more liberal line of credit than the bank. The latter could perform a similar service, except for the fact that it is not equipped to investigate and supervise to the extent that the credit corporation is. Selling on the installment plan is a hazardous business if not properly supervised, but with proper supervision the risk is small. The average loss by furniture merchants on bad debts is about one-half of one per cent of the total sales.[1] However, about four per cent of all furniture sold on the installment plan is repossessed and resold.[2] The percentage would be higher except for the fact that the cost of repossessing and reselling is very great; and most stores are very lenient in such matters, as they do not wish to gain uncalled for notoriety.

Attitude of the Banker towards Credit Companies. The banker's main objections to the activity of the credit corporations are: (1) It is secret, (2) it fosters overtrading, (3) it is ruinously expensive, and (4) an individual disposes of his best assets. (1) has already been discussed in a previous chapter, and shown to be no more secret

1 Statistics furnished by "The Grand Rapids Furniture Record."
2 These figures were obtained by "The Grand Rapids Furniture Record," which sent questionnaires in 1921 to the furniture merchants of the country. See also article entitled "Can People be Trusted?" American Magazine, November issue, 1919.

to the general creditors of a firm than the Notification Plan (open assignment of accounts to a banker), which is freely practiced by many banks. The fact that it is secret as far as the banker is concerned has just been discussed in this Chapter.

(2) Macleod[1] says of overtrading: "Numbers of merchants and traders purchase commodities on Credit, that is they incur obligations which they must discharge at a future day, in the hope that the returns will come in before the day of payment. But the immense quantity of goods poured in usually gluts the market in a short time, and, from the excess of supply, prices tumble down often to nothing, so that goods become unsalable and either no returns at all come in, or such as are quite inadequate to meet the outlay. When this occurs it is called "*Overtrading*[2].

No one realizes what is the result of overtrading better than the credit companies' officials. The more progressive ones know that their ultimate existence depends upon doing that which is for the best interests of their clients. However, it is not to be denied that the credit companies have in many instances fostered overtrading. But has the United States ever passed through a greater period of expansion and overtrading than that just fostered by the bankers themselves?[3] The solution of the problem is for bank-

1 A well known Scotch authority on credit and banking.
2 See "Elements of Banking" by Henry Dunning Macleod.
3 See Bradstreet's report for the year 1921.

ers of all descriptions to regard themselves as overseers or guardians of our general credit structure. The many failures of banking institutions of all kinds, due in great part to unwise expansion, should forcibly impress this fact upon the financial minds of our country.

(3) The bankers state that selling open book accounts is ruinously expensive. The fact remains that thousands of concerns sell their accounts and report profits. The banker's contention that it is expensive may be admitted. But so is the installation of labor saving machinery in a factory, or the double tracking of a railroad system expensive; yet when intelligence dictates it few will deny the wisdom of either procedure.

(4) An individual disposes of his best assets. The answer to this is that he merely changes the form of a non-liquid asset into money, the best of assets.

The commercial banker should not oppose the credit corporations, because they operate for the greater part on money borrowed from the banks. It is impossible for the former to make a profit unless its charges are greater than what it pays the bank for the borrowed money. In that case the business man will seek accommodation from the bank rather than from the credit company. But there is, and will continue to be, a large class of businesses that require so much supervision, detail and investigation, that the banks, not equipped to handle it, will be forced to turn it over to the credit corporations.

Conclusion. The weight of evidence seems to be on the side of the credit companies. The mere fact that a concern is willing to pay about one and one-half per cent interest[1] or commission a month to the credit corporation, and then in addition give proper security, shows that it expects to make a greater profit out of the transaction itself. The fact that hundreds and thousands of firms are yearly seeking aid from the credit companies and profiting by it shows that they fulfill a distinct service in our economic life. They especially supply a much needed link in our credit chain in the financing of articles sold on the installment plan, for there is no other type of institution in this field adequately equipped to carry on the work now performed by these companies.

Credit corporation officials should realize the importance of their positions and appreciate the responsibility of their offices. They should regard themselves as part guardians and supervisors of our credit organization; realizing that they represent a new type of banking that is assuming increasing importance in our financial life. It is true that some of their business is being absorbed by the banks. But as old lines of credit are taken away, new ones will be opened up. The field of credits has only been scratched. There are many lines of business that today are suffering from want of proper credit accommodation. The com-

1 Usually in the form of a commission, as state usury laws would prevent interest being charged.

mercial banking companies should extend their activities into these virgin territories.

CHAPTER VI

STATISTICAL DATA CONCERNING CREDIT COMPANIES

There are in the United States approximately one hundred and twenty-five credit companies.[1] This number was obtained by employing one of the well known "Mercantile Credit Agencies" to write the following letter to sixty-four of its branch offices throughout the country. All of the branch offices were not written to, as some were located in small towns or in sections where they would be reported upon by a neighboring office.

"Could you furnish us with the names of all finance or credit companies which operate in your territory? By finance or credit companies we mean all financial

1 It is very hard to determine the exact number of *credit* corporations, as there are many *finance* companies which carry on a business similar to that of the credit corporation, and in addition perform other types of financing. Again there are probably a large number of smaller concerns throughout the country which are not included in the author's computation. Private individuals also, in many localities, finance the sale of articles sold on the installment plan.

institutions which purchase accounts receivable, on the Non-Notification Plan, or finance the sale of any article sold on the installment plan, such as automobiles, trucks, farming implements, furniture, musical instruments, gas and electric appliances, etc."

The results were very carefully gone over and every effort was made to eliminate those corporations from the list which did not come under the author's definition of credit companies as set forth in chapter one. It is not maintained that the following figures are absolutely accurate, yet it is believed that they serve as a fair index of the scope and activities of this new type of financing which has assumed national importance within the last few years. In fact, the dates of incorporation of the majority of these companies are from 1918 to 1921.

According, then, to the author's computation, the amount of paid-in capital stock represented by the credit companies in the United States is approximately $100,000,000.00. If it is assumed that this much is borrowed again from the banks, which is indeed a very conservative estimate, as many of the credit companies have from two to four times the amount of their paid-in capital stock outstanding in collateral trust notes, we obtain the figure of $200,000,000.00. It must be taken into consideration that this capital is turned over many times during the year. By a careful examination of the volume of business done by many representative credit companies it is safe to

estimate that their capital is turned over on an average of at least six times a year. If the above obtained figure of $200,000,000.00 is multiplied by six, the substantial aggregate of $1,200,000,000.00 is arrived at; which will give the reader some idea of the size and influence of the modern credit corporation movement.[1]

Earnings. The apparently unusual profitableness of these concerns has induced many to enter upon this field of activity. As a result of this many of the smaller companies today are failing or on the point of failure. The gross earnings of a credit corporation[2] on its capital stock are only around eighteen per cent.[3] When all overhead, including taxes and losses on bad loans, are paid for, and a small surplus laid aside, the stockholders would be fortunate if they obtained from six to seven per cent on their invested capital. But what enables them to realize more on their investment is the employment of the collateral trust note idea. By borrowing one or two times their paid-in capital from the banks at rates ranging from six to nine per cent, and then loaning this out at about eighteen per cent. the resulting profit makes the investment in the stock of the credit company a much more profitable one, because the overhead expenses do not have the same proportionate increase as the earnings.

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1 The author does not maintain that these figures are accurate, but only that they serve to give some idea of the size of this new type of financing. He believes that they err on the side of conservatism.

2 That is, those devoted to the assigned account business.

3 This does not include charges for bonding which some of the companies require.

The deposits of a commercial bank bear an analogous relationship to the collateral trust notes of the credit corporation. They both enable the two institutions to make a substantial profit on borrowed capital. Of course, both the bank and the credit company have to stand back of borrowed money and be prepared, in the case of the one to pay it back upon call or thirty days notice, and in the case of the other at maturity.

It is an indisputable fact that the profits of a credit company would be scant and meagre, if it were not for the employment of the collateral trust note idea. The detail, supervision and risk would take a large bulk of the eighteen per cent gross profit, so the only fact that makes the credit corporation a really profitable enterprise is the increased capitalization obtained by means of borrowed money. It is the same procedure that makes bank stock profitable. So it seems that any outcry against the profits of a credit company or its charges, as long as they are confined to around eighteen per cent.[1] should be held equally applicable to the profits of banks. They both perform types of financing. Only the credit company's service is of such a character that it requires much more investigation, supervision and detail than the banks; so a higher fee is charged.

[1] This does not include charges for bonding which some of the companies require. Also the gross charge of credit companies devoted to the financing of articles sold on the installment plan amounts to more than eighteen per cent. The ostensible charge is around twelve per cent, but as the installment notes are paid off monthly the actual charge is thus much greater than eighteen per cent. Yet it must be remembered that there is an enormous amount of detail work and supervision involved. In addition the charge must be such as to compensate for the risk assumed, and to provide for the possible cost of repossession and resale.

In order to show the comparative profitableness of the two types of institutions there are reproduced below the present dividend rates based on the par values of the stocks of all the principal banks, trust companies and credit corporations in the City of Baltimore. Baltimore is popularly, though mistakenly, known as the home of the "Credit Companies." The movement started there at an early date (1909) and has grown to great proportions in that locality. In fact, Baltimore boasts of some of the most successful and prosperous credit companies in the United States. For this reason the author feels that the following comparison, containing some of the most successful of the credit corporations in the country, should be regarded as a high index of their earnings.[1]

QUOTATIONS OF THE STOCKS OF BANKS, CREDIT AND TRUST COMPANIES LOCATED IN BALTIMORE (As of January 27th, 1922.)

BANKS	Par	Paid in Capital	Div.		Last Sale
Baltimore Commercial Bank	100	750,000	6%		125
Calvert Bank	50	100,000	14%		125
Canton National Bank	100	100,000	5%		
Citizens National Bank	10	2,000,000	24%		42¾
Commonwealth Bank	50	200,000	10%		90
Drovers & Mechanics National Bank	100	600,000	12%	1% Ex.	225
Farmers & Merchants National Bank	40	650,000	6%		45
Merchants National Bank	10	2,500,000	12%		18¾
National Bank of Baltimore	100	1,500,000	10%		175
National Bank of Commerce	15	1,200,000	15%		35
National Exchange Bank	100	1,500,000	8%		140
National Marine Bank	30	400,000	8%		40
National Union Bank	100	1,000,000	7%		140
Old Town National Bank	10	350,000	7%	1% Ex.	13
Second National Bank	100	500,000	12%		280½
Western National Bank	20	500,000	8%		29½

1. These statistics taken of credit companies in other cities might not show as h a degree of earning power.

TRUST COMPANIES

Baltimore Trust Company	50	1,000,000	20%		155
Colonial Trust Company	25	300,000	7%		33¼
Continental Trust Company	100	1,350,000	12%		160
Equitable Trust Company	25	1,250,000	8%		40
Fidelity & Deposit Company	50	3,000,000	16%		112
Fidelity Trust Company	100	1,000,000	16%		295
Maryland Trust Company	100	1,000,000	6%		112¼
Mercantile Trust & Deposit Company	50	1,500,000	20%	2% Ex.	210
Safe Deposit & Trust Company	100	1,200,000	20%		510
Security Storage & Trust Company	100	200,000	10%	2½% Ex.	170¼
Title Guarantee & Trust Company	100	200,000	20%		205
Union Trust Company	50	500,000	10%	2% Ex.	91¼

CREDIT COMPANIES

Baltimore Acceptance Company:				
Preferred	25	300,000	7%	25
Common, No par value		5,000	0%	25
Commercial Credit Company:		Shares		
Preferred	25	1,500,000	7%	25½
Preferred B	25	1,500,000	8%	26
Common	25	1,500,000	12%	51
Federal Finance:				
Preferred	100	700,000	7%	100
Common, No par value			0%	50
Finance Company of America:				
Preferred	25	18,000	7%	24
Common	25	150,000	6%	27½
Finance & Guaranty Company:				
Preferred	25	466,025	7%	25
Common	25	350,000	10%	36¼
Finance Service:				
Preferred	10	278,880	7%	8
Common	10	163,370	10%	12½
Guaranty Company:				
1st Preferred	100	500,000	7%	100
2d Prefe rred	100	500,000	8%	100
Common	1	33,000	0%	15
Maryland Finance Corporation:				
Preferred	100	179,000	7%	100
Common	1	14,450	0%	5
Manufacturer's Finance Company:				
1st Preferred	25	800,000	7%	25
2d Preferred	25	300,000	7%	25
Common	25	800,000	16%	43
National Credit Corporation:				
Preferred		100,000	7%	
Common				

It is not maintained that any accurate conclusions can be drawn between the relative profitableness of these three types of institutions, due to the fact that the banks and trust companies have been engaged in business for a much longer period than the credit companies. However, the

popularly supposed phenomenal earnings of credit corporations are shown to be entirely mythical.[1]

It is interesting to note that a credit company's common stock can be very profitable if preferred stock and collateral trust notes are outstanding to several times the amount of common. A fixed rate of approximately seven to eight per cent is paid on the preferred and the notes. All the earnings of the total capitalization over this charge are then applicable to the relatively small amount of common stock. For example, take the Commercial Credit Company of Baltimore with its $1,500,000 first preferred, its $1,500,000 second preferred, its $1,500,000 common, its average of approximately $7,000,000 collateral trust notes outstanding and its $1,300,000 surplus and undivided profits. In addition to this it owns all of the common stock in two other credit corporations, The Commercial Acceptance Trust of Chicago, and The Commercial Credit Company, Incorporated, of New Orleans. The Baltimore Company obtains the benefit of the surplus earnings of these other two companies. The history of the common stock of the Commercial Credit has thus been one of substantial dividends, with frequent extra disbursements. As pointed out by the chairman of its Board of Directors, this has been due to its favorable form of capitalization rather than to the extremely large earnings generally credited to it.[2]

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1 At least as far as those located in Baltimore are concerned.

2 For example a net earning of only fourteen per cent on its Stockholders' Investment (Capital, Surplus, and Undivided Profits) means about forty per cent ne ton its common stock.

NUMBER.....

CERTIFICATE 100%.....

RESERVE 20%.....

CHARGED 80%.....

COMMISSION %.....

CHEQUE %.....

TRIPLICATE CERTIFICATE OF INDEBTEDNESS

THIS IS TO CERTIFY THAT THE PERSONS NAMED BELOW ARE INDEBTED TO THE UNDERSIGNED IN THE SUMS SET OPPOSITE THEIR RESPECTIVE NAMES, FOR GOODS SOLD, SHIPPED AND DELIVERED.

Date of Invoice		NAME OF DEBTOR	ADDRESS	Due Date Net Cash		Amount of Invoice	PLEASE LEAVE BLANK					
Mth	Day			Mth	Day		d'te	Payments	Balance	Reserve	Rating Brad.	Rating Dun.

| | | |

THE————————————CORPORATION

CONTRACT

This Agreement entered into between..... designated as first party, and THE————————————CORPORATION, a————————corporation, its successors or assigns, designated as second party.

Witnesseth, That Whereas first party is desirous of selling to second party, Accounts Receivable, Notes, Leases, Mortgages, Contracts and Choses in Action, hereinafter designated as "Accounts," evidencing sales and deliveries of personal property usually dealt in by first party. Now Therefore, in consideration of the premises, the statements made to the second party regarding the financial condition of the first party, and the mutual covenants hereinafter mentioned, the parties hereby agree as follows:

FIRST. Second party will from time to time, during the continuance of this agreement and within the limits agreed upon, buy such Accounts, belonging to first party as may be acceptable to second party, and will pay therefor.

One hundred per cent (100%) of the net face value thereof, less a charge equal to the legal rate of interest on the money outstanding thereon, on which –77– per cent of the net face value thereof shall be paid in cash upon acceptance thereof by second party, and the remaining –23– per cent less any deductions and plus any overpayments by the debtors and less total charges, as shown in lines 51 to 60 hereof, to be paid to the first party immediately upon payment of any such Accounts to second party; provided, that no payments of any such remainder need be made so long as any Accounts purchased hereunder are affected by any breach or violation of warranty hereunder, but such remainder and any moneys, Accounts or property of first party which may come into possession of second party may be held and applied to the payment of any such Accounts.

SECOND. In order to obtain from second party the right and privilege which are hereby given, to make collection at its office and expense of all Accounts sold to second party and thereby avoid objections by, and any possible loss of trade from any of its customers, through second party collecting the Accounts direct from the Debtors, first party will pay second party for the salaries and all expenses ot travel of auditors of second party, who shall have the right to call every thirty days or oftener and inspect, f audit, check and make extracts from the books, Accounts, records, orders, original correspondence and other papers of first party relating to Accounts sold hereunder as provided in any fidelity bond which may be obtained by second party; said right and privilege may be terminated by second party at any time, and shall terminate immediately upon the suspension of business, request for general extension, bankruptcy petition, or any act amounting to a business failure, by or against first party. First party warrants that it will transmit or deliver to second party at its office in————————————on the day of receipt thereof, all original checks, drafts, notes and other evidences of payment received, in payment of, or on account of, any Accounts purchased hereunder.

THIRD. Second party will: (a) Place its collection department at the disposal of first party, and upon request endeavor to collect direct from the debtors any Accounts purchased hereunder. (b) Have its auditor give first party his report of each examination as above, with full instructions as to the best method of keeping the books, records and Accounts of first party. (c) Place its credit department at the disposal of first party and pay for all accounting, postage and credit investigation of Accounts purchased or offered for purchase hereunder and upon request give credit and financial advice. (d) Have its employees at the request of first party instruct first party how to increase sales, organize the business of first party in an efficient manner, and increase the profits of first party. (e) Permit first party to submit any of its sales contracts with its customers to the General Counsel of second party for advice and opinion as to the form and legality thereof. (f) Accept at par subject to payment all remittances received through first party, and pay the cost of all exchanges on same. (g) Obtain and have on hand at all times sufficient funds to make prompt remittance to first party for all acceptable Accounts within the limits agreed upon. (h) Supply all forms proper for assignment of Accounts hereunder and assist in the prompt collection thereof.

FOURTH. The total compensation to be paid by first party for all services and other considerations specified in lines 12 to 16 hereof, added t ı the charge as mentioned in lines 12 and 13 hereof, it is hereby agreed shall be:

FIFTH. In consideration of the prompt purchase and remittance by second party for Accounts acceptable to second party, without waiting to make a complete credit investigation thereof, first party hereby warrants that: (a) First party and each debtor named in an Account is solvent and will remain so until maturity thereof; (b) There will be no suspension of business, request for general extension, bankruptcy petition, nor any act amounting to a business failure by or against first party or any debtor (c) Every Account purchased hereunder and any settlement received thereon will be paid in full at maturity in cash or————par funds; (d) Prompt payment will be made to second party of the net invoice value of any goods returned, rejected, re-sold, re-routed in transit, or of any allowance or credit upon any Account sold to second party; (e) Each Account offered for sale to second party, shall represent a bona-fide sale and delivery of property usually dealt in by first party, and shall be for a certain undisputed, liquidated claim or demand, which is due or to become due on the dates set forth; (f) First party will not sell or assign any of its own Accounts elsewhere without first giving ten days' written notice to second party of such intention.

SIXTH. Contemporaneously with the purchase of Accounts hereunder, first party will, by proper instrument in writing, assign and set over to second party such Accounts purchased by it as aforesaid, to the end that second party may be and become subrogated to all of the rights, securities or guaranties possessed by the first party in respect thereto, including the right of stoppage in transit; should the latter right be exercised, or should the debtor named in any account fail or refuse to accept, receive or retain, or return the property evidenced by such Account, or should said property be re-routed or re-consigned, then the title to said property or property exchanged therefor, with the right to sell or otherwise dispose thereof, and the title to any new Account created through the re-sale thereof, shall be and remain in said second party. Immediately upon consummation of the purchase of Accounts hereunder, the first party will make upon its books suitable and proper entries disclosing the absolute sale of said Accounts to second party. First party further will execute and deliver to second party any instrument necessary, proper or convenient to carry into effect the terms, provisions and conditions of this agreement, or to facilitate the collection of Accounts purchased hereunder.

SEVENTH. If any warranty, expressed or implied, made herein or resulting from the provisions hereof with respect to any Account or made in or resulting from the provisions of the assignment of any Account to second party or from the subject matter hereof, shall be broken or violated, either through the act of first party or others, the damages which second party shall be entitled to recover from first party, as a result thereof, shall include all attorney's fees, Court costs and all other expenses which may be expended or incurred by second party to obtain or to enforce payment of Account purchased hereunder, either as against the debtor, first party, or any of its guarantors, or in the prosecution or defense of any action or concerning any matter growing out of or connected with the subject matter of this contract, and Accounts purchased thereunder. Granting extensions to, or adjustments of claims of debtors named in Accounts purchased hereunder, compromises, compositions or settlements of such Accounts, either with the debtor or others, or of the sale, assignment or transfer of Accounts thereunder by second party, shall not affect the liability of first party under any of its warranties as herein provided.

EIGHTH. First party does hereby make, constitute and appoint.....
or....., or any person whom either or second party may designate, its true and lawful attorney, with power to receive, open and dispose of all mail addressed to first party; to endorse the name of first party upon any notes, checks, drafts, money orders or other evidence of payment or collateral that may come into the possession of second party of or upon Accounts purchased by it hereunder; to endorse the name of the first party on any invoice, freight or express bill or bill of lading relating to any said Account; to sign the name of first party to drafts against debtors, to assignments and verifications of Accounts and notices thereof to debtors; and to do all other things necessary or proper to carry out the intent of this agreement.

NINTH. Neither of the parties hereto shall be bound by anything not expressed in writing by and between the parties;this agreement and all of its provisions shall inure to and become binding upon the parties, their heirs, executors, administrators, successors and assigns only after acceptance by two duly authorized officers of second party; the provisions of this agreement shall be construed and interpreted in accordance with the laws and decisions of the State of————first party hereby waives all notice of any matter to which it might otherwise be entitled, also waives presentment, demand any protest of any note, draft or other evidence of payment; either party hereto shall have the right at and time, upon written notice, to cancel this agreement as to future transactions.

IN WITNESS WHEREOF, first party has caused these presents to be executed this.....

day of.....19.....

ATTEST
or ..... Signed.....(Seal).....
WITNESS President, Partner or Owner.

Accepted by THE————————CORPORATION, this.....

day of.....19.....

By.....(Seal)..... By.....(Seal).....
Treasurer or Ass't. Treasurer. President

THE FOLLOWING GUARANTY AND WAIVER IS TO BE SIGNED BY INDIVIDUALS.

In consideration of the acceptance by "second party," of the aforementioned agreement between the "first party" and "second party," of other valuable considerations, and of the sum of One Dollar in hand paid to each of the undersigned, the receipt of which is hereby acknowledged, the undersigned and each of them do hereby jointly and severally guarantee to second party, its successors or assigns, the full and prompt payment, performance and discharge by first party of said agreement, and of each and every of the agreements, terms, provisions, and conditions set forth in said agreement, and of any rider or riders to be thereto attached, and of any other instrument or instruments given or executed in pursuance thereof, provided to be done, paid or discharged by the first party, and the due execution thereof. The undersigned and each of them do hereby agree that the liability hereunder shall be direct and not conditional upon the pursuit by the second party, its successors or assigns of whatsoever remedies it or they may have against said first party, and shall continue until second party receives written notice revoking said liability on future accounts or transactions, and they and each of them do hereby waive, release, assign and transfer to second party, so far as the obligation herein is concerned, all rights in and to homesteads and exemptions to which they or any of them may be entitled under the laws of any State or States.

This guaranty and waiver shall be construed and interpreted according to the laws and decisions of the State of————The undersigned hereby jointly and severally waive all notice of default by first party, and waive notice of acceptance of the guaranty by second party, and waive all other notices to which they might be otherwise entitled.

IN WITNESS WHEREOF, we have hereunto set our hands and seals this.....
day of.....19....

Witness..... Signed.....(Seal)
Witness..... Signed.....(Seal)
Witness..... Signed.....(Seal)
Witness..... Signed.....(Seal)

TO THE_____CORPORATION

Baltimore, Md.

Dear Sirs:—For the purpose of inducing The_____Corporation to enter into a contract to purchase Accounts Receivable, Notes, Contracts, and Choses in Action hereinafter designated as "Accounts." And Thereafter, and from time to time, to purchase Accounts, the undersigned hereby makes and delivers to The_____Corporation the following statement of its assets and liabilities, which statement shall be considered as continuing and authorizing The_____Corporation to act upon it and use it as the basis for making such contract to purchase Accounts and thereafter, and from time to time, as the basis for the purchase of said Accounts as and when said statement shall continue as being substantially correct and to be used and acted upon as aforesaid until the undersigned shall notify The_____Corporation of any material change in the financial condition of the undersigned.

In consideration of the making of the aforementioned contract and of the purchase of said Accounts, the undersigned agrees that if the undersigned at any time should fail, become insolvent or commit an act of bankruptcy, or if any of the representations made below are untrue, or if the undersigned fail to notify The_____Corporation of any material change as before agreed; then and in any such case, all obligations of the undersigned held by or for The_____Corporation shall immediately become due and payable without demand or notice and the same may be charged against any balance the undersigned may have with The_____Corporation, the undersigned hereby giving The_____Corporation a continuing lien upon such balance of account from time to time existing to secure all obligations of the undersigned held by or for The_____Corporation.

ASSETS			LIABILITIES		
CASH on hand			ACCOUNTS PAYABLE (Unsecured)		
CASH in Banks			For merchandise		
Name of Bank			All other		
Name of Bank			ACCOUNTS PAYABLE (Secured)		
Name of Bank			For merchandise		
ACCOUNTS RECEIVABLE			All other		
Due from business customers, good			NOTES PAYABLE OR ACCEPTANCES, (Unsecured)		
Due from partners or other than customers			Banks (Give names)		
NOTES RECEIVABLE:			"		
Due from business customers, good			For merchandise		
Due from partners or other than customers			All other		
STOCK INVENTORIES:			NOTES PAYABLE OR ACCEPTANCES secured by any part of reported Asset or otherwise, including own banks, (Give details)		
Finished product (how valued)					
In process of manufacture (how valued)			BONDED DEBTS (When due)		
Raw materials and supplies					
PROPERTY AND PLANT:			MORTGAGE DEBTS (full details)		
Land and buildings					
Machinery and fixtures			CHATTEL MORTGAGES		
Teams and automobile trucks					
OTHER ASSETS:			DEPOSITS OF RESERVES WITH US:		
			By		
			Total liabilities		
			Net worth		
Total Assets			Total		

1. Are any of the above assets pledged as collateral?.....

2. Are any of the above Liabilities secured by collateral?.....

3. Contingent Liability: Accommodation Indorsements?.....

4. Customers' Notes Discounted.....

5. Have you ever sold or assigned any of your Accounts Receivable? If so, to whom and when?.....

6. Insurance carried: Accounts Receivable?.....Merchandise $..... Plant $..... Machinery, etc. $.....

7. The basis of above statement is from (Actual) (Estimated) Inventory by Mr.....date.....

8. Our regular months for taking Actual Inventory and closing books are.....

9. What were total expenses last 12 months?.....

10. What was total gross profit last 12 months?.....

11. What was net (loss) (profit) last 12 months?.....

12. Amount of Annual Sales $.....Amount of Common Sales $.....

13. Our net losses by failures have not exceeded.....% on our gross sales during any one of the last .....years

14. If you have a Bond issue or Mortgage state specifically:
    (a) What items on your statement are covered by it?.....
    (b) By Whom held?.....
    (c) When payable?.....

15. Do you sell mostly to Manufacturers, Jobbers or Retailers?.....

16. Is trade local or scattered?.....

17. Is any of your merchandise on Consignment, Approval, or subject to guarantee or test?.....

18. Have you or any of your Officers or Partners ever failed in business?.....

19. Have you ever had a fire loss?.....

20. Are there now any legal proceedings for debt of any unsatisfied judgments standing against you, or any of your Officers or Partners? Answer fully.....

Questions for a Corporation:
- Capital: Authorized $.....Subscribed $.....Paid in: Cash $.....Other Property $.....
- Incorporated in the year.....under the Laws or by Special Act of the State of.....

Officers:
- President....., worth outside of business $.....
- Vice-President....., worth outside of business $.....
- Secretary....., worth outside of business $.....
- Treasurer....., worth outside of business $.....

Questions for a Partnership:
- Names of each General Partner and the respective net worth of each outside of business: Mr.....Net worth $.....
- Mr.....Net worth $.....
- Mr.....Net worth $.....

The above statement, both printed and written, has been carefully read by the undersigned, and is a full and correct statement of the financial condition of the undersigned as of.....19.....

Dated and signed under seal at.....this.....day of.....19.....

In the presence of

.....
Witness

Sign here.....(Seal)

Corporation or Partnership

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